



## 2010 BUDGET BREAKFAST SEMINAR

Polson Higgs will run a breakfast seminar on Friday, 21 May where Bill English's budget from the previous day and in particular the tax issues which will impact on the business community will be analysed and considered.

Please contact us if you would be interested in attending. Invitations will be sent nearer to the date.

## TRANS-TASMAN RETIREMENT SAVINGS PORTABILITY

A recent proposal may open the way for New Zealanders returning home from Australia to bring their retirement savings with them with effect from second half of 2010.

New Zealanders with retirement savings from certain Australian superannuation funds can transfer their funds into KiwiSaver when they return home permanently.

In the same way, Kiwisaver members who are moving to Australia will be able to transfer all of their savings in the scheme, including Crown contributions and any member tax credits to the Australian complying superannuation scheme.

## USE-OF-MONEY INTEREST RATES

Use-of-money interest rates on underpaid and overpaid tax have been lowered in line with changes in the market rates on which they are based. The current rate charged by Inland Revenue on unpaid tax is **8.91%**, while the rate for overpayments of tax paid by Inland Revenue is **1.82%**.

## R&D CREDITS

The research and development tax credit was repealed with effect from the 2009/10 income year. It does however remain available for the 2008/09 income year.

The tax credit is for 15% of eligible expenditure on R&D activities. The credit is subtracted from the taxpayer's tax liability. If the amount of the credit exceeds the tax liability the balance is used to reduce other tax liabilities or is refundable in cash.

Companies will receive an imputation credit for a tax liability satisfied by way of an R&D tax credit allowing benefits to be enjoyed by shareholders when profits are distributed as dividends.

You need to contact Polson Higgs as soon as possible if you want to claim R&D credit as the deadline for lodging claims is 30 April 2010.

## THE MYTH OF MARKET RATE SALARIES – LANDMARK DECISIONS!

The legality of common business structures that have the effect of income minimisation, involving income generated from professional or skilled services using companies and trusts, has been in question since the controversial decision in the Taxation Review Authority Case V20/W33 in 2005. It was held in this case that a dentistry practice was transferred to and carried on by a trading trust for tax-avoidance purposes, because the dentist taxpayer was receiving a below market salary.

Case V20/W33 has remained untouched until March this year when the High Court delivered landmark decisions in *Penny v. CIR* and *Hooper v. CIR*.

In these cases two orthopaedic surgeons sold their private practices to companies owned by a family trusts, and then became employees of the respective companies and received salaries for their services. Inland Revenue argued that this was a clear case of tax avoidance, lacking a commercial purpose. Further, that the salaries paid were below the market rate and that an adjustment increasing them to what the Inland Revenue judged as 'commercially realistic' must be made. The Court rejected this argument and made the following key observations:

The transfer of the practices to the companies did alter the incidence of tax, because tax was payable by a different taxpayer and because the tax rates were different, but this is not of itself tax avoidance;

The adoption of a company structure involves an entirely orthodox commercial decision with no element of artificiality or contrivance;

The Income Tax Act does not in general terms require that particular types of income only be derived by some categories of taxpayer. The Court therefore rejected the Inland Revenue's argument that income earned from personal effort must be taxed to the individual and cannot be taxed in another entity;

Nothing in the Income Tax Act required the payment of a commercially realistic salary in a non-arm's length party situation.

The fact that the individuals managed to retain ultimate benefit

of the funds earned via their companies and received via their trusts was not an indication of tax avoidance.

While the outcome of *Penny* and *Hooper* is welcomed, it could still prove to be only a temporary win as the Inland Revenue has filed a notice of appeal. However the decision of the Court of Appeal will be at least some months away. In the meantime the outcome remains uncertain and we recommend discussing this with your Polson Higgs tax advisor.

### **TAX CHANGES AFFECT ASSOCIATED PERSON RULES**

Amendments to tax legislation have resulted in major tax changes which will impact on future property purchases by property developers and dealers as well as builders starting construction, together with associated entities.

These changes widen the tax base and are aimed at those who are associated with people or entities in the business of building, or dealing in, or developing land. The effect of this extended definition greatly restricts the ability for a builder, developer or dealer to hold property as a tax free capital investment in another entity. There will now be many more taxpayers tainted by association, resulting in investment properties acquired by them being subject to tax on profit when sold.

If a taxpayer is associated with a property developer, dealer or builder and disposes of their investment property within 10 years, they may now be exposed to tax on any profit that might have been considered a capital gain previously.

Note the following key points:

Tax law changes will affect property transactions that have occurred since 6 October 2009.

- » In some circumstances, the changes will affect land which is already held as a capital investment where improvements have been made after that date.
- » In most cases we believe that the existing structures you may have are unlikely to provide adequate protection from the tax consequences of these changes.
- » The changes to the definition of associated persons are extremely wide and it will become much more difficult to design an ownership structure that prevents investment properties being tainted.
- » You should take greater care when structuring future property transactions and seek advice before undertaking any property transaction.

To ensure you understand the impact of these changes in managing your tax exposure, contact your Polson Higgs adviser to discuss your situation.

### **SALE OF PRIVATE HOMES TO LAQCS CAN BE TAX AVOIDANCE – TRA CASE Z20**

It has been a long standing view of the Inland Revenue that people selling their own or family homes into an LAQC and then renting

the property back to themselves constitutes tax avoidance. This is because they are claiming tax deductions for the property that would otherwise have been considered to be private expenses that are not tax deductible.

This view has recently been confirmed by the TRA in Case Z20. In that case, a taxpayer entered into an arrangement by renting her residential home from a LAQC in which she was the sole shareholder. This generated tax losses to the LAQC, as a landlord, which were passed on to the shareholder to reduce her personal taxable income.

The TRA decision emphasized the need to look beyond legal form and consider the economic substance of an arrangement to determine whether it constitutes tax avoidance. TRA also commented that the taxpayer's arrangement was not commercially realistic and involved artificial pretences resulting in the taxpayer 'manufacturing an artificial business operation'. Some of the factors that influenced this decision were:

- » No written tenancy agreement
- » No bond was ever paid
- » No rent increase or rent review
- » Transactions entered into were recorded by book entry only

If you are currently operating a similar structure we are able to provide advice to minimise the risk of the structure coming within the boundaries of tax avoidance.

### **SELLING PROPERTY PURCHASED “OFF THE PLAN”**

The Inland Revenue Department has recently targeted the profits on the sale of properties that are resold before the purchase contract is settled. A booklet recently published circulated by the Inland Revenue on the issue states:

“Some people mistakenly believe that because their names do not appear on titles there is no need to declare these sales”. It goes on to say that, “With few exceptions, these sorts of transactions are taxable in the same way as other property transactions.”

One of the determining factors is the taxpayer's intention at the time of acquiring the property. The Inland Revenue states that, ‘With interests in property sold prior to a contract becoming unconditional, we will presume an intention of sale.’

The reality however is not that simple. Whether such sales are taxable or not will depend on a number of factors. In our view the IRD's booklet could be misleading and could lead to taxpayers paying tax on sales where they are not required to under the legislation. We recommend you seek our advice before assuming such sales are taxable.

#### **FOR FURTHER INFORMATION PLEASE CONTACT:**

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